REPORT OF THE CALIFORNIA LAW REVISION COMMISSION ON CHAPTER 178 OF THE STATUTES OF 2004 (SENATE BILL 1746)

Unincorporated Associations

Senate Bill 1746, authored by Senator Dick Ackerman, implements the California Law Revision Commission recommendation on *Unincorporated Associations*, 3 Cal. L. Revision Comm'n Reports 729 (2003). The new and revised Comments set out below supersede the comparable Comments in the recommendation and reflect amendments made to Senate Bill 1746 in the legislative process.

Corp. Code §18610. Contract liability of member of nonprofit association

Comment. Section 18610 is new. It specifies the scope of personal liability of a member of a nonprofit association for a contractual obligation of the association.

Subdivision (a) is consistent with former Section 21101 and with the Statute of Frauds. See Civ. Code § 1624(a)(2).

Subdivision (b) is consistent with the common law rule that a member of a nonprofit association is liable for a contractual obligation that the member has expressly authorized or ratified. See Security-First National Bank of Los Angeles v. Cooper, 62 Cal. App. 2d 653, 145 P.2d 722 (1944). Subdivision (b) does not continue the common law rule that a member is liable for a contract that the member has impliedly authorized or ratified. Authorization and ratification may not be inferred from mere participation in the governance of the association — express approval of the contract is required. For example, approval of bylaws, election of officers, or participation in a vote in which the member votes against authorization or ratification of a contract would not constitute express authorization or ratification of a contract.

Subdivisions (d) and (e) provide for liability where the member is acting as an agent of the nonprofit association. Compare Section 18615(b) & (c). See also 2 B. Witkin, Summary of California Law *Agency* §§ 144-48, at 141-44 (9th ed. 1987) (agent not liable for contract on behalf of disclosed principal); *id*. §§ 144-45, at 141-42 (agent liable for contract if agent lacked authority); Civ. Code §§ 2342 (warranty of authority), 2343(2) (bad faith representation of authority).

See also Sections 18005 ("director" defined), 18015 ("member" defined), 18020 ("nonprofit association" defined), 18025 ("officer" defined).

Corp. Code § 18615. Contract liability of director, officer, or agent of nonprofit association

Comment. Section 18615 is new. It specifies the scope of liability of a director, officer, or agent of a nonprofit association for a contractual obligation of the association.

Subdivision (a) is consistent with former Section 21101 and with the Statute of Frauds. See Civ. Code § 1624(a)(2).

Subdivision (b) is consistent with existing law providing that an agent is not liable for a contract entered into on behalf of a disclosed principal. See 2 B. Witkin, Summary of California Law *Agency* §§ 144-48, at 141-44 (9th ed. 1987).

Subdivision (c) provides that a director, officer, or agent is liable for a contract executed on behalf of an association if the director, officer, or agent lacks authority to execute the contract. See Civ. Code §§ 2342 (warranty of authority), 2343(2) (bad faith representation of authority); B. Witkin, *supra* §§ 144-45, at 141-42.

See also Sections 18005 ("director" defined), 18020 ("nonprofit association" defined), 18025 ("officer" defined).

Corp. Code § 18630. Application of alter ego doctrine to nonprofit association

Comment. Section 18630 is new. It provides that the common law alter ego doctrine applicable to corporations may also be applied to nonprofit associations. The alter ego doctrine is summarized in *Communist Party of the United States v. 522 Valencia, Inc.*, 35 Cal. App. 4th 980, 993, 41 Cal. Rptr. 2d 618 (1995) ("In general, the two requirements for applying the alter ego doctrine are that (1) there is such a unity of interest and ownership between the corporation and the individual or organization controlling it that their separate personalities no longer exist, and (2) failure to disregard the corporate entity would sanction a fraud or promote injustice.").

In applying the alter ego doctrine to a nonprofit association, a court should take into account differences between a nonprofit corporation and a nonprofit association. For example, failure to observe corporate formalities may be a factor in a decision to impose alter ego liability on shareholders of a corporation. Although it would be unreasonable to expect a nonprofit association to observe the governance formalities required of a corporation, it might be reasonable to expect that a nonprofit association will follow the governance formalities it has established for itself. Failure to do so may indicate that the personality of a nonprofit association and its members are not truly separate.

Failure to provide a corporation with reasonably adequate assets to cover its prospective liabilities may justify imposing alter ego liability on shareholders of a corporation. In *Automotriz del Golfo de California v. Resnick*, 47 Cal. 2d 792, 306 P.2d 1 (1957), the court relied in part on inadequate capitalization to justify imposing alter ego liability:

> If a corporation is organized and carries on business without substantial capital in such a way that the corporation is likely to have no sufficient assets available to meet its debts, it is inequitable that shareholders should set up such a flimsy organization to escape personal liability. The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffectual to exempt the shareholders from corporate debts. It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.

Id. at 797 *quoting* Ballantine on Corporations (1946). This principle could also be applied to a nonprofit association. However, it would be necessary to carefully consider the nature of the association to determine what level of unencumbered capital would be reasonably adequate for the association's prospective liabilities. For example, a small historical society, operating a museum that is open to the public, should probably insure against liability for any injuries suffered by the public while in the museum. Such insurance might reasonably be considered adequate capitalization. On the other hand, an association that publishes controversial and potentially defamatory commentaries about public figures might reasonably anticipate greater risk of liability. If the association fails to insure against that risk or maintain a cash reserve to satisfy any judgment against it, a court might conclude that the association is inadequately capitalized.

If, as an incident to its nonprofit purpose, a nonprofit association conducts for-profit business activity, the appropriate levels of capitalization and insurance for that activity would be analogous to the capitalization and insurance that a for-profit entity should carry when conducting similar business activity.

See also Sections 18015 ("member" defined), 18020 ("nonprofit association" defined).
